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Luncheon Speech**

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Thank you very much for that kind introduction. Nine years ago, which was the last time I had the privilege of speaking to the Press Club, I had just come from a baseball game my son had played in.

My son was the second "gaijin" in history to play in the Tokyo Senior Boys' League. He played for a team called the Minato Moose. The Minato Moose was coached by the famous -- I might say infamous -- Mrs. Nomura. And the night before that speech, he had finally earned his right to play on the team. And he came home very proudly after a very long practice outside of Yokohama and was given the two characters to put on his uniform, his number and his patch for the Tokyo Senior Boys' League. He had finally made the team. My wife and I stayed up all night long. We had to take the thread out of one of her dresses, because it matched the color of his uniform, to have it sewn on by six o'clock in the morning.

My job was to remove the thread. My wife's job was then to sew the two characters onto his uniform. And so the next morning he departed for practice and that evening in our tiny little space in our little flat, the door opened, he threw down his baseball glove, and he broke into tears. He said, "Mama and Dad, you sewed the two characters on upside down!" So, I made a vow at that point that in my understanding of Japan, I would seek never to have an upside down understanding, but a right side up understanding.

It has been nine years since I last spoke at this Press Club, at the beginning of my tenure as a U.S.-Japan Leadership Fellow. My life, as you mentioned, has been quite eventful in that interim period, but as the 14th century Buddhist monk Kenko writes in his Essay on Idleness:

"It is very boring when you meet a man after a long separation, and he insists on relating at interminable length everything that has happened to him in the meantime."

So in deference to this great Buddhist sage, I will spare you my own reminiscences and talk instead about what has happened to all of us in the meantime and where we might go from here.

Many changes in Japan have taken place since I left. In fact, many changes have taken place in the world at large. The Cold War ended. Germany was reunited. The Soviet Union dissolved into 15 not-so-easy pieces. America's economy, which, when I was here, was in a slowdown, was burdened by dramatically high government deficits and considered by many to be in terminal decline, best characterized by Professor Paul Kennedy's Rise and Fall of Great Powers

-- an America few had hoped for -- is now in its longest peacetime expansion ever.

On the other hand, Japan's economy, then considered an irresistible force -- the day I arrived, the Nikkei-Dow was at 39,000; it had a pristine government balance sheet, and a sky-is-the-limit sense of promise as summarized by the book written by Ezra Vogel, Japan as Number One -- has since been in a decade-long decline and suffering from financial decay.

Moreover, the Asian region, which was then emerging as the world's most important growth center, has plunged into a financial crisis and economic contraction, creating tremendous economic hardship and signs of political unrest in the region. These changes in the region and the world have made the U.S.-Japan bilateral relationship more important than ever for each other and for the world.

From a security point of view, Japan remains our most important ally in the region. Unsettling developments in the region, from the firing of a missile by North Korea last year to the political unrest caused by the financial crisis, makes our strong and vital security alliance with Japan even more vital. That security relationship is the cornerstone -- it is the cornerstone -- of our peace and security in this region, and it provides ballast in an uncertain and stormy regional sea.

In the same way, our two economies have never been more important to each other. Accounting for about 80% of regional GDP, early Japanese economic recovery is necessary for regional recovery, and is necessary for world recovery.

Japan is, I like to remind people, our third largest market, behind Canada and Mexico, but it remains our largest single overseas market, as well as our greatest trade policy challenge. While American companies are enjoying good sales in certain sectors, in others they have faced decades of serious market access problems. On the other hand, Japan is becoming increasingly dependent on American consumers, who now buy nearly one-third of all Japanese exports.

In short, this is an important relationship worth nurturing, for the sake of security, for the sake of peace, for the sake of prosperity for Japan, for the United States, for the region, and for the world. And we must work to perfect our relationship. Doing so will require what my friend Yotaro Kobayashi calls a sense of "tsuuka," or instinctive trust and rapport.

In such a relationship the parties involved never really have to specify what they want from a relationship. But let me say up front what we want from our relationship with Japan: we want a strong, vital, vibrant Japanese economy.

JAPAN'S CHALLENGE

Japan clearly faces serious challenges in the years ahead. Since the end of 1990 the Japanese economy has grown by an average of less than 1% a year; in the last two years the

economy has contracted. Huge fiscal spending has been needed to spur economic growth, but that growth is not sustainable without dramatic structural change to boost productivity needed to boost competitiveness, in turn, and to assure that Japan can meet the needs of its aging society.

The banking system remains deeply troubled by bad debt. The Diet has passed some very useful laws, but implementation remains to be seen. The insurance industry -- particularly the life industry -- is plagued by problems with asset quality and is in need of significant overhaul.

Unemployment is rising, particularly among the young. Despite years of sacrifice by young people and their parents, university graduates are not getting jobs. A Japanese friend of mine whose daughter is graduating from Sophia University this spring tells me that 30% of her graduating class cannot find work.

There is a deep-seated pessimism among the Japanese people. The Associated Press reported last week, for example, that the Japanese reading public is snapping up books on failure.

And finally, as trade imbalances rise, as the moderator pointed out, trade tensions are building with Japan's main trading partners, including the United States.

FROM THE MACHINERY AGE TO THE INFORMATION AGE

My impression is that at the root of Japan's problems lies an economic structure that no longer can deliver higher standards of living for Japanese; a structure that has slowed the transition from the age of machinery to the age of information; a structure that has slowed the transition from an age in which governments controlled economic outcomes to one in which they are impartially and transparently applying regulation. I think it is important as friends, as allies, and as brothers and sisters in a key strategic relationship, that we share with you our own experience with a difficult predicament as we were presented with, indeed, while I was here nine years ago.

U.S. Experience

The U.S. success due to decisions to deregulate structures built in the 1930s and the 1940s and the 1950s, in which the government imposed controls on input, output and prices, is, I think, a story worth telling.

Deregulation did not just appear out of nowhere in the United States. It was the product of efforts and struggles and, by the way, mistakes over many decades. It was led by pioneers such as George Stigler of the Chicago School and the Brookings Institute in the 1960s, by Senator Edward Kennedy, who championed airline deregulation in 1974, and the Carter Administration which eagerly embraced the agenda under Alfred Kahn's able leadership in the late 1970s; Alfred Kahn, whom many of you probably do not even remember. In fact, we used to comment on his odd personal behavior during our administration. He really is a tremendous hero in the United

States because of his active force behind deregulation.

All this was the result of bruising political battles between liberalization forces in the Carter Administration and in the Reagan Administration and their successors, against vested interests in the trucking and railway and shipping industries.

The Clinton Administration has continued this policy of aggressive regulatory reform, including continued efforts to deregulate telecommunications, culminating in the Telecommunications Act of 1996. And this Administration's "open skies" efforts have enhanced airline liberalization throughout the world.

This effort has paid off. Airlines have dropped their airfares 26%. Long distance telephone call [rates] have plummeted. Railways were able to cut costs, which we now estimate at between \$50-70 billion in operating costs, and finally started making profits again.

But perhaps most important of all -- and this is the key point -- deregulation created jobs. Total employment in the U.S. airline industry has increased nearly 80% over the past decade while Japan's airline industry created only 32% more jobs. The U.S. has created 17 % more telecom-related jobs since 1993; and Japan only 3.3% has been the rate of increase in telecom jobs.

The private sector, of course, went through its own restructuring after no longer being protected by regulators who were protecting franchises in Washington. If you look at the data, for those of you who want to go into the weeds on the subject of the Fortune 500 companies, you see a dramatic shift that took place once this process began. If you look at the data for the top 500 operating corporations in America that ran from the 1970s through 1987, you would find that margins of the top 500 companies -- that is, margins of profit -- did not increase by one tenth of 1% over that period; that their inventory turnover did not increase by one tenth of 1% over that long period; that their return on assets did not increase by one tenth of 1% over that period. Instead what they did was leverage up their return on equity based on gifts given by the marketplace. One was leveraging their balance sheet and the second were tax reductions that they were given by the Reagan Administration.

When that game came to a halt, when it was patently clear that they could no longer hide behind the protection afforded them by Washington, they went to work and began to do business the old-fashioned way, to work their plant and equipment more efficiently, to cut prices and redundancies. They could no longer hide behind the umbrella of inflation as the wall came down and the Cold War was over, and more labor was released to the marketplace, more commodities released to the marketplace. They had no choice but to adjust to the modern economy and begin to work their way up the value-added ladder.

I might add, one other change that took place, which I think is ill-understood, or under-understood in our country, was also the dramatic shift in ownership of our corporate

structure. I like to point out to audiences that when Bill Clinton was elected President, 26.5 million Americans owned equity mutual funds. Today the figure is closer to 70 million. Now, of course, we are eager to take credit for that phenomenon, but the fact is it occurred in a very short period over the last six years. And as a result, the demands for corporate governance have reinforced the need for corporations to operate efficiently and continue to adjust to the information age. The result is that American business, and the American economy, is primed to lead in the information age. By removing the protection of inefficient regulation, by forcing creative minds of the private sector to lead the transition from the old way of doing business to the new, we overcame the predicament forecast by the Paul Kennedys and Ezra Vogels of the world.

Japan's Problem

This transition has been much slower in Japan. The Japanese Government, to our eye, based on our experience, is too concerned about regulating outcomes. As a result, almost everything a Japanese company pays today -- from telephone calls, to energy bills, to the rent they pay on their offices -- is more expensive than their foreign competitors.

Each of these things makes firms weaker and makes them less able to compete internationally. This, in turn, creates a cycle in which industries, unable to compete, lobby for protection. So rather than encouraging companies to become leaner, to become more efficient, to become more productive, it is our view that the Japanese Government is sheltering them from competition and creating a downward spiral.

Japan's construction industry, one of the world's least efficient, illustrates the extent of the problem. Though the need for structural adjustment in the industry has been long acknowledged in Japan, it is interesting to note that there are 55,000 more construction companies established today than there were here in 1989.

By the way, other signs of this working through the system are clearly evident. Just adding parenthetically, and perhaps non-sequentially here, it is interesting to note that spreads have been widening on corporate bond issues since last year as the market is increasingly beginning to distinguish what markets would call losers from winners in the marketplace.

The Government -- plain and simple -- has just not provided a good environment for companies to adjust. The legal system is seriously underdeveloped. Recently there is a shortage of lawyers to deal with corporate bankruptcies, there are few trained lawyers and accountants to do due diligence on real estate deals, bankruptcy laws are inadequate, and the lack of international accounting standards impedes mergers and acquisitions. Moreover, regulations restrict labor mobility, poor corporate governance inhibits profit-maximizing behavior, and land restrictions raise the price of investment.

The market has also questioned the practice of pumping money into the corporate sector

via government-linked financial institutions. One analyst has noted that this constant government-linked support runs the risk of becoming a narcotic, delaying needed structural change.

The result is that Japan is falling behind. For example:

- Investment in the telecom area has fallen for the past two years, in sharp contrast to the United States and Europe where telecom investment is increasing rapidly.
- Japan's long-protected airlines are among the world's costliest and least efficient. Japan's poor yet costly airport and port facilities are leading to Japan-passing as airlines and shipping firms are starting to build their hubs in cheaper, more efficient facilities throughout Asian cities.
- Japan has lost high tech jobs to Korea and to Taiwan in the DRAM area while failing to enter new areas. For example, while Japanese companies -- and government -- endlessly debated which standard to use for advanced digital compression technology (which is called MPEG), American companies simply forged ahead and developed a new product and now dominate the sector, where Japan should have been extremely competitive.
- And Japan continues to fall behind in medical technology due to a system which does not reward innovation. The new reference pricing system, which is being contemplated, if implemented, will hobble Japanese medical and pharmaceutical industry even more than its position today.

One result is that Japanese entrepreneurs are leaving the country. Japan is the only OECD country with net emigration, with many of Japan's best and brightest making the decision to look elsewhere for challenge and opportunity, and Japan can ill-afford such a brain drain.

RESTRUCTURING AND REGULATORY REFORM

Our goals are complementary to those of Japan. I want to state it again, and I will state it repeatedly: we want an economically strong, vital, vibrant Japan, because we prosper if you do and because a prosperous Japan is a more stable security partner.

To achieve real sustainable growth, create jobs, assure a healthy competitive industry, and support an aging population, Japan must introduce greater competition into its economy. And, as I have just pointed out, our experience has shown that the best way to do so is to open, deregulate and restructure the economy.

Regulatory reform has been the centerpiece of America's Japan trade policy for years. It goes back to 1980 where nearly half of our trade agreements have been aimed at pro-competitive regulatory reform. It includes the Market Oriented Sector Specific (MOSS) talks in the 1970s to

remove restrictions on telecommunications and medical and pharmaceutical technology. It includes our talks on the Structural Impediments Initiative. It includes our Enhanced Deregulation Initiative at the Denver Summit by President Clinton and former Prime Minister Hashimoto.

We believe that the initiatives we are pursuing will strengthen Japan's economy over the long term. For example:

- We are pressing for changes that will reduce Japanese telephone charges, which are presently amongst the highest in OECD, including bringing down interconnection charges, which are as much as five times those in the United States, and making rights of way for laying new networks more reasonable. Currently, for example, new carriers who wish to string wire on NTT telephones must pay NTT \$17,000 per telephone pole in adjustment costs. Now very few can afford that cost.
- We are pushing Japan to adopt performance-based standards and testing requirements on housing materials to help Japan meet the government's -- the Japanese government's -- stated goal of reducing housing costs by 20%.
- We are asking that Japan move from a monopoly to a competitive electricity market by, among other actions, eliminating burdensome tests on inspection requirements and starting to use performance-based standards to help meet their goal -- the Japanese government goal -- of reducing energy costs to one third -- or, excuse me, by one third -- in order to reach world levels. That is, a unit of electricity in Japan costs a Japanese business three times what it costs in the rest of the industrialized world.

We are working with the Japanese Government on this year's deregulation package which can build in the areas I just mentioned and other areas on the package that we agreed to in Birmingham last year. We look forward to a forward-leaning and vigorous package of measures which will make a real difference, for all involved, not just for foreign companies seeking to compete in Japan, but for Japanese companies, as well.

OPEN, RULES BASED TRADE

Open, rules-based trade is fundamental to Japan's own prosperity. It is fundamental to Asia's recovery. It is fundamental to global economic health. It is fundamental to the health of the United States' economy.

In this regard, it is critical that Japan abide by its trade commitments, for these commitments, at their core, will introduce greater competition necessary to strengthen Japan's own ability to compete while preserving the openness of foreign markets.

Japan must first fully implement its trade bilateral and multilateral market opening

agreements in sectors such as insurance, and autos, and glass, and procurement and agriculture.

Second, it is critical that Japan ensure that its trade with other nations in sectors such as steel, where exports to the U.S. in some key products have surged over 400% over the past year, is fair and rules-based. As you know, the Clinton Administration is firmly committed to ensuring that free trade remains fair trade.

Finally, we need to work together to expand open and fair trade. We were very disappointed, as many know, with APEC, that is the last ministerial. But we look forward to completing the sectoral liberalization initiative this year in the WTO and to working with Japan and other nations to launch a new ambitious, new round of WTO talks in the United States at the end of this year -- at the WTO ministerial, which will take place, incidentally, in Seattle.

CONCLUSION

We have suggested ways, based on our own experience and, by the way, on our own trial and error, for Japan to overcome its current difficulties. We are giving this advice because of our strong interest in having a confident, healthy and prosperous partnership with Japan. And as I have said, this partnership is vital not only to Japan, but to our own country and to all the regions of the world.

Japan faces a very difficult task, one that it will address in its own way, of course, and taking into account its own needs. We believe Japan is up to this task. In the past 50 years this country has astonished the world. It has become Asia's economic and technological leader. It has built Asia's most prosperous and peaceful society. And there is no question that it has the strength and capability which the crisis of the moment -- and the hopes for the next century -- demand of the Japanese people.

These things were true the last time I spoke at the Press Club; and they are true today.

Thank you very much.